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¶1. (U) Provided below is Embassy Buenos Aires' Economic and Financial Review covering the period January 18-21, 2010. The unclassified email version of this report includes tables and charts tracking Argentine economic developments. Contact Econ OMS Megan Walton at WaltonM@state.gov to be included on the email distribution list. This document is sensitive but unclassified. It should not be disseminated outside of USG channels or in any public forum without the written concurrence of the originator. It should not be posted on the internet.

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GoA Says Debt Swap Moving Forward

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¶2. (SBU) In a radio interview January 19, Minister of Economy Amado Boudou denied that the debt restructuring is facing any obstacles from the US Securities and Exchange Commission (SEC), adding that the swap is moving forward as scheduled and the GoA anticipates a 60% participation rate. His statement came in response to local press articles over the weekend reporting that additional information requests by the SEC regarding the debt swap signaled problems for moving it forward. According to the press reports, the SEC requested that the GOA provide details on the integrity of the National Statistical Agency and its method to calculate inflation, inquired about the risk of attachment of official funds by holders of defaulted Argentine debt, and asked for clarification regarding purpose and operation of the debt repayment fund (the so-called Bicentennial Fund) that the GoA is trying to establish with central bank reserves to pay (or guarantee) 2010 debt payments. The Minister said that the GoA had expected and received on January 15 SEC requests for additional information that is the norm for debt swaps and that the GoA is preparing to response by January 22. Boudou noted that the GoA and the SEC had three information exchanges for the 2005 debt exchange.

¶3. (SBU) Meanwhile, Secretary of Finance Lorenzino, who is on a road show to the UK, Italy, and Germany to promote the swap with holdouts there, stated in a press interview that the GoA is on track to launch the debt restructuring with the remaining holdouts in late January/early February and expects to complete the process by the end of February.

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Congress Bicameral Commission to issue its view on Central Bank President removal

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¶4. (SBU) In a press conference on January 19, President Cristina Fernandez de Kirchner announced that she has asked Congress (currently in summer recess until March) to set up as soon as possible the Bicameral Budget and the Finance Commissions to issue a view on her intent to remove Central Bank (BCRA) President Martin Redrado. [Background: On January 8, the President issued a DNU (necessity and urgency decree, N 18) removing Redrado without Congressional recommendation (arguing that it was in summer recess) after Redrado refused to resign at CFK's request for failing to implement a previous GoA decree to set up a $ 6.57 billion fund (the "Bicentennial Fund") with Central Bank reserves to pay 2010 debt payments. [See previous Embassy reporting on this issue]

¶5. (SBU) The Bicameral commission to review Redrado's removal is composed of five members: the Presidents of the Lower House Budget and Finance Commissions, the Presidents of the Senate Budget and Finance Commissions and the vice-President. The President of the

Lower House, Eduardo Fellner requested January 20 that the two commissions meet on January 21 to elect their Presidents. Reportedly, pro-Kirchner Deputy Gustavo Marconato will head the Budget Commission, while opposition Deputy (from the Coalicion Civica) Alfonso Prat-Gay will lead the Treasury Committee. While the Senate has not yet set up its commissions, the GoA is pushing for the commission to issue its recommendation with just three members as it meets the required quorum. The GoA has stressed that the commission's recommendation is nonbinding and that CFK can legally dismiss Redrado once the commission has released its findings.

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Primary fiscal surplus declining; GoA spending up

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¶6. (SBU) In a press conference January 19, Minister of Economy Amado Boudou announced that the primary fiscal surplus reached ARP 5.1 billion in December, compared to a deficit of ARP 3.5 billion in 2008. He also noted that the full-year 2009 primary fiscal surplus declined 47% y-o-y to ARP 17.3 billion, equivalent to 1.5% of GDP -- well below the 3.1% level of 2008, but higher than the GoA revised 2009 budgeted figure of 0.5%. However, the primary fiscal surplus figure is mainly the result of two accounting gimmicks that inflate the surplus: (1) accounting as revenues US$ 2.5 billion (ARP 9.6 billion) received in 2009 from the IMF Special Drawing Rights (SDRs) allocation to the BCRA (this amount is determined by the member country shareholder stake); and (2) accounting as earnings ARP 8.3 billion from the ANSES (Social Security Agency) investment portfolio. In addition, total revenues were augmented with the unorthodox addition ARP 5 billion from the nationalized pension funds and the BCRA transfer of extraordinary profits (from unrealized profits due to the peso depreciation) of US$1.2 billion in 2009. Absent the unorthodox accounting, the GoA would have posted a primary fiscal deficit in 2009.

¶7. (SBU) During the year, revenues totaled ARP 260.2 billion (up 19%), while primary expenditure reached ARP 242.9 billion (up 30%), raising concerns regarding the GoA's ability to rein in spending in ¶2010. Taking into account interest payments on debt, the overall fiscal balance shows a deficit of ARP 7.1 billion, (equivalent to 0.6% of GDP), compared to a 2008 overall fiscal surplus of ARP 14.6 billion (1% of GDP). In its press release, the GoA noted that in the middle of an international economic crisis, Argentina maintained its three economic pillars: the two twin surpluses (fiscal and trade) and a high level of international reserves, which allowed the country to weather the crisis without economic disruptions or fiscal adjustments.

Inflation UP

¶8. (SBU) National statistics agency INDEC announced January 15 that December 2009 inflation increased 0.9% m-o-m, in line with market expectations of INDEC announced figures, but well below private estimates of an actual increase in inflation of about 2% m-o-m. The highest price increases were in food and beverage (1.6%), entertainment (2.2%) and clothing (1.6%). For the year, INDEC estimated that inflation increased only 7.7%., in sharp contrast with private estimates of 15-17% y-o-y.

¶9. (SBU) Most private analysts expect inflation to accelerate slightly in 2010 to between 18-20%, due to higher commodity prices,

the recovery of domestic demand, the expected elimination of energy and transport subsidies, unanchored inflation expectations (see item below), and a loose fiscal policy coupled with a high salary inertia.

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Inflation expectations dropped to 20%

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¶10. (SBU) On January 18, the Finance Research Center of Di Tella University reported that inflation expectations for the next twelve months dropped to 20% in January, from 25% in December. Inflation expectations have kept steady during the whole year, hovering around 20%, except in the months of February, August and December when they jumped to 25%. As part of the end-of the year survey, Di Tella also surveyed people's perceived inflation during the last year. Surprisingly, people estimated that 2009 inflation was 30%, much higher than true inflation estimates of approximately 17%, demonstrating the downside of a lack of public confidence in INDEC.
KELLY